STATE OF MICHIGAN
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GOVERNOR
OFFICE OF FINANCIAL AND INSURANCE SERVICES
DEPARTMENT OF CONSUMER & INDUSTRY SERVICES
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DATE: May 19, 2003

LETTER NO.: 2003-CU-04

TO: The Board of Directors and Management of Michigan State-Chartered Credit Unions

SUBJECT: 2003 First Quarter Financial Results

The Office of Financial and Insurance Services (OFIS) compiles call report information to monitor Michigan state-chartered credit unions, both individually, and in the aggregate. The purpose of this letter is to share some overall industry trends and highlight certain areas of particular concern based on the March 31, 2003 call report filings.

Summary

Overall, Michigan's 274 state-chartered credit unions remain in sound financial condition and continue to provide quality products and services to their members. Credit union membership remained relatively stable for the quarter and numbered just over 2.66 million. Total assets increased significantly at a rate of 22.25% (annualized) for the quarter and now exceed $17.35 billion. Loans declined for the second consecutive quarter, and total just over $9.82 billion.

Asset growth increased significantly compared to prior quarters. Loan delinquency, charge-offs and net income remained stable, while net worth ratios declined. Areas of regulatory concern identified in our analysis of the March 31, 2003 call report information include the following:

Upsurge in Credit Unions Reporting Losses

There are 35 credit unions reporting a net loss for 2002, four more than last quarter. Another 31 credit unions report very weak Return on Average Assets (ROAA) ratios of 0.20% or less. The annualized aggregate ROAA at December 2002 is 0.85%, up five basis points from last quarter.

Earnings are a credit union's only source of net worth. Poor earnings performance jeopardizes the long-term viability of an institution, and should be a cause for serious concern to credit union officials.

Net Worth Erosion

The aggregate net worth ratio of Michigan state-chartered credit unions declined from 11.05% to 10.59% during the first quarter of 2003, most likely caused by the sharp increase in total assets during the same period. Thirty credit unions report net worth ratios below 8%.

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Stable Asset Quality Trend
Overall delinquency and net charge-offs remained stable at 0.94% and 0.47% (respectively) during the quarter. Only two credit unions had an increase in the net charge-off ratio of more than 100 basis points over the last twelve months, compared to nineteen as of December 31, 2002. There were 24 credit unions with a net charge-off ratio over 1.5% at March 31, 2003, one less than at December 31, 2002.

High Asset Growth
The growth rate for all Michigan state-chartered credit unions is 22.25% (annualized) for the first quarter of 2003, up considerably from the 9.10% reported for 2002. One hundred and twenty-four credit unions report annualized asset growth over 20% at March 31, 2003, nearly nine times the number reported at December 31, 2002.

Unplanned or poorly managed growth can cause operational problems and erode earnings and net worth. Boards and management teams should carefully review their credit union's asset growth relative to loan demand and net worth position. The incremental net margin on additional funds acquired should be evaluated by comparing the cost of funds to the return available on safe, liquid investments. Dividend and interest rates paid on member savings should be managed to ensure that growth is controlled and an adequate level of earnings maintained.

Conclusion
Prudent risk management includes identifying and quantifying potential risks and adverse trends timely, and taking appropriate steps to ensure that risks are properly managed. Boards of directors and management teams must monitor the financial condition of their credit union on an ongoing basis to ensure that satisfactory performance and safe and sound operations are maintained.

A written plan of action should be developed when adverse trends or financial conditions are identified. This plan of action serves to document your board's awareness of the problem and intended actions to control and correct the adverse conditions.

I hope the information in this letter is helpful in making informed business decisions. Operating a financial institution safely and soundly requires diligence in risk identification, measurement, and management. The stresses evident in the March 2003 statistics highlight the need for application of sound management practices in an increasingly uncertain economic environment.

Very Truly Yours,

Roger W. Little, Deputy Commissioner
Credit Union Division